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March 16, 2010

PUBLIC UTILITIES
COMMISSION

2010 MAR 16 P 2:45

FILED

The Honorable Chairman and Members of
the Hawaii Public Utilities Commission
Kekuanaoa Building
465 South King Street, 1st Floor
Honolulu, Hawaii 96813

Dear Commissioners:

RE: Docket No. 2009-0049 -- Application of Wai'ola O Moloka'i, Inc. For Review and Approval of Rate Increases; Revised Rate Schedules; and Revised Rules.

The purpose of this letter is to transmit the Division of Consumer Advocacy's ("Division") Statement of Probable Entitlement in the instant proceeding.

The Division's calendar erroneously reflected that the due date for the Statement of Probable Entitlement was this upcoming Friday (March 19, 2010) instead of the identified date (March 11, 2010) in the Hawaii Public Utilities Commission Order Approving Proposed Procedural Schedule, As Modified filed on November 6, 2009. This error was not noticed until today.

The Consumer Advocate apologizes for any inconvenience and understands that the Commission will give this late filing the appropriate weight when determining the interim decision and order in the instant proceeding.

Sincerely yours,

Jon S. Itomura
Supervising Attorney

JSI:dl

c: Michael H. Lau, Esq.
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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)	
)	
WAI'OLA O MOLOKA'I, INC.)	DOCKET NO. 2009-0049
)	
For Review and Approval of Rate Increases;)	
Revised Rate Schedules; and Revised)	
Rules.)	

DIVISION OF CONSUMER ADVOCACY'S
STATEMENT OF PROBABLE ENTITLEMENT

Pursuant to the Commission's Order Approving Proposed Procedural Order, issued on November 6, 2009, the Division of Consumer Advocacy ("Consumer Advocate") respectfully submits its Statement of Probable Entitlement in the above docketed matter.

I. INTRODUCTION.

HRS § 269-16(d) states that an interim decision allows the Hawaii Public Utilities Commission ("Commission") to grant an increase in rates, fares and charges, if any, to which the Commission believes the public utility is probably entitled based on the evidentiary record in a ratemaking proceeding. It is the Consumer Advocate's

understanding that this statutory provision was enacted to be fair to both the utility and the ratepayer. There is mitigated adverse impact, if any, to the utility from any delays in implementing the rate relief that is deemed just and reasonable by granting the utility interim rate relief, based upon the revenue requirement to which the Commission will likely find reasonable in its final decision and order (i.e., the increase in revenue requirement to which the utility is probably entitled). Should the interim rate relief be higher than the relief found to be just and reasonable in the final Decision and Order, the ratepayer is protected since the public utility must return, in the form of an adjustment to rates, any amounts received under the interim rates that are in excess of the rates, fares, or charges finally determined to be just and reasonable by the Commission. Interest that is computed at a rate equal to the rate of return on the public utility's rate base found to be reasonable by the commission must also be imputed on the amount to be returned.

Given the above, the determination of probable entitlement should be based on that level of revenue requirement and resulting rates which the Commission is likely to determine in the final decision and order to be just and reasonable based on the evidence in the record.

II. PROCEDURAL HISTORY.

On March 2, 2009, Wai'ola O Moloka'i, Inc. ("WOMI") filed its Application for Approval to Increase Rates ("Application"). WOMI's Application included the direct testimonies, exhibits and workpapers in support of its Application. The Commission

ordered WOMI to re-file its Application to include the filing of audited financial statements by WOMI.

On June 29, 2009, WOMI re-filed its Application and the Commission confirmed completion upon issuance of its Order Regarding Completed Application and Other Matters, issued on July 31, 2009.

On September 3, 2009, an advertised public hearing was held at the Mitchell Pauole Center Conference Room in Kaunakakai, Molokai, as required by HRS § 269-16, with notice pursuant to HRS § 269-12.

On September 11, 2009, the County of Maui ("County") filed its motion for intervention or to participate in the proceeding with the Commission.

On September 14, 2009, Stand for Water filed its respective motion for intervention or to participate in the proceeding with the Commission.

On October 16, 2009, the Commission granted intervention to the County and unilaterally named Molokai Properties, Limited ("MPL") as a party.

Pursuant to the Commission's Order Approving Proposed Procedural Order, filed on November 6, 2009, the Consumer Advocate submitted several rounds of information requests to WOMI and in turn, WOMI submitted its relevant responses.

The Consumer Advocate filed its Direct Testimony and Exhibits on January 13, 2010.

On January 27, 2010, the Commission, on its own motion, dismissed Stand for Water as an intervenor based upon the Commission's determination that Stand for Water failed to assist in developing a sound record and participate meaningfully in the docket.

As a result, the remaining parties to the proceeding are WOMI, the Consumer Advocate, and the County.

Settlement discussions are ongoing, however, pursuant to the Procedural Order, the parties are to file their respective Statement of Probable Entitlement on March 11, 2010, and the Consumer Advocate is to file its Response to WOMI's Statement of Probable Entitlement on March 19, 2010.¹

III. DISCUSSION.

A. BACKGROUND REGARDING THE PRESENT RATES.

The currently effective rates were approved by the Commission in its Order Approving Temporary Rate Relief for Molokai Public Utilities, Inc. and Wai'ola O Moloka'i, Inc. ("Temporary Rate Relief Order") filed in Docket No. 2008-0115 on August 14, 2008. The current effective rates were implemented to address the apparent, urgent need for rate relief for Molokai Public Utilities, Inc. ("MPUI") and WOMI, who, if their asserted needs were not addressed, contended that they would be terminating utility service to all of its service customers. Otherwise, the last Commission approved rates for WOMI that were the result of a complete investigation were derived in its CPCN application in Docket No. 7122, wherein the Commission filed Decision and Order No. 12125, filed on January 13, 1993.

For purposes of the Consumer Advocate's analysis, the Consumer Advocate used the rates approved in Decision and Order No. 12125 since temporary rates are generally not taken to be "permanent" rates as they are not the result of a complete and

¹ Due to a clerical calendar input error, the Consumer Advocate filed its Statement of Probable Entitlement on March 16, 2010 instead of March 11, 2010 pursuant to the Procedural Schedule.

full record as is developed in a standard rate proceeding. The Consumer Advocate's position appears to be supported by the Commission's Order Denying Wai'ola O Moloka'i, Inc.'s Request To Submit Its Unaudited Financial Statements In Lieu Of Audited Financial Statements filed on April 2, 2009 in the instant proceeding. As set forth in its discussion on page 8 and in ordering paragraph four, the Commission instructed the utility company to calculate any increase using the rates approved in Decision and Order No. 12125 as the base since calculating any increase using the temporary rates approved in Docket No. 2008-0115 would be "misleading and improper."²

B. THE CONSUMER ADVOCATE'S REVENUE REQUIREMENT IS REASONABLE.

First, the Consumer Advocate would like to make clear that it continues to take seriously the possible risk that, if not properly compensated, a utility company might not be able to provide quality and reliable service to utility customers. Usually, this risk is possible or remote, but not probable. In WOMI's instance, given its public statements in 2008, the Consumer Advocate seriously considered the risk associated with WOMI again asserting that it would terminate services if the revenue requirements authorized by the Commission would not allow sufficient coverage of WOMI's fixed and variable costs. This consideration, when combined with the Consumer Advocate's extremely heavy workload and limited resources, resulted in a review that, while complete, did not

² The Consumer Advocate notes that WOMI's position appears to be that the Consumer Advocate's position is incorrect. See, for example, page 2 of WOMI-RT-100.

attempt to recommend every possible adjustment that could have been raised.³ Still, the Consumer Advocate contends that its recommended revenue requirements reflect a reasonable level that would allow WOMI to recover sufficient revenues to cover costs but still reflects a significant increase that will hopefully not unduly burden WOMI's customers.

As identified on WOMI-R-1, page 1, the major differences in the test year expenses are as follows:

- Regulatory Expense (\$48,466);
- Labor and Benefits Expense (\$26,003); and
- Depreciation Expense (\$25,796).

The major differences in rate base are primarily related to the concern that WOMI was not able to adequately address and support the assertion that all plant costs are properly recorded, supported by proper documentation, and not otherwise recovered through other means (difference of about \$1 million). The difference in sales relates to the Consumer Advocate using more updated data that resulted in estimates that varied from WOMI's estimates, which was based on earlier data.

Rather than recounting each revenue requirement element, the Consumer Advocate will only discuss the major outstanding differences. In addition, the Consumer Advocate will not go over each difference in great detail as the Consumer Advocate has already discussed these issues and has offered the reasons why its recommendations are reasonable as set forth in the Consumer Advocate's direct testimony. Furthermore,

³ See pages 8 through 11 of CA-T-1 for a greater discussion of the Consumer Advocate's general analytical approach.

the Consumer Advocate contends that WOMI has not adequately addressed these concerns in its rebuttal testimony and, thus, the Consumer Advocate contends that its recommendations in its direct testimony remain reasonable.

1. Plant and Associated Depreciation.

The Consumer Advocate has recommended disallowance of certain plant items because the Company has reflected book depreciation for certain items, but has not reflected any tax depreciation for these items. As a result of its inability to find records on why this discrepancy occurs, WOMI has recommended that all income taxes expenses and associated items should be excluded from the instant proceeding. The associated items would essentially consist of accumulated deferred income taxes with the accumulated Hawaii State Capital Goods Excise Tax Credit also being excluded. The Consumer Advocate is concerned that if WOMI's recommendation were adopted, this would not be sound policy as the Commission should make clear that it is any utility company's responsibility to meet its burden of proof by providing a complete case with ample supporting evidence and that, if an integral item such as income taxes, which affects multiple revenue requirement elements, cannot be supported, a utility company should not be allowed to simply recommend excluding all such items.

The Consumer Advocate's recommendation was that the Commission should consider either suspending the docket or dismissing the application to allow this matter to be resolved. If either one of these is adopted, the currently effective temporary rates should continue until the Commission approves some other set of rates. In the alternative, if the Commission decides that it is appropriate to continue moving forward

in this proceeding, WOMI should be required to provide reasonable estimates for income taxes, accumulated deferred income taxes, and capital goods excise tax credit balances. Further, if no support can be provided to justify why it is appropriate to reflect book depreciation without corresponding tax depreciation, the appropriate amounts should be excluded from the plant in service balance and the estimated depreciation expense.⁴

2. Regulatory Expense.

The Company originally estimated \$55,000 in its original application and did not modify this estimate in its amended application. However, as outlined in its rebuttal testimony, WOMI is now estimating that its regulatory expense should be \$103,466. The reasons for this significant increase are discussed on pages 14 through 19 of WOMI-RT-100. The Consumer Advocate is concerned that such significant costs are being incurred for this rate proceeding and, more importantly, the Consumer Advocate is concerned with the possible impact on ratepayers if the Company's revised estimate is adopted for ratemaking purposes.

3. Labor and Benefits Expense.

WOMI's labor and benefits expense test year estimate was \$141,449 and the Consumer Advocate recommended that certain adjustments be made, primarily to reflect the removal of one position that was not going to be filled, the removal of any

⁴ See, the discussion in CA-T-1, pages 33 through 43.

salary increase, and to reflect the reduction of benefits to reflect a greater level of contributions from employees for those benefits.⁵

WOMI's rebuttal testimony acknowledges the fact that the position in question will not be filled and should be removed from the test year estimates.⁶ However, WOMI contends that it should be allowed to reflect an increase in its pay rates, reflect the Company's almost 100% coverage of all employee benefits and any resolution to the benefits issue should be allowed to be reflected in the next rate proceeding.

Given the current economy, where people are still being asked to endure pay cuts, furlough days, etc., WOMI's recommendation in its rebuttal testimony does not adequately justify its recommendation. It is the utility company's burden to justify the amounts included in its request. Thus, if the Company contends that the wages and salaries increases and the full benefits coverage should be allowed, the Consumer Advocate contends that WOMI must demonstrate that its compensation package is inadequate and that, without such increases, WOMI will not be able to attract and/or retain qualified employees, it should provide that information.

4. Other Matters.

As discussed earlier, the Consumer Advocate's discussion in this statement of probable entitlement focused on the major differences between WOMI and the Consumer Advocate. There are other areas which reflect differences between the parties. Some of these differences relate to calculated numbers, such as working cash

⁵ See pages 18 through 21 for CA-T-1.

⁶ See pages 5 and 6 of WOMI-RT-100.

and taxes other than income taxes. Other items are relatively nominal as compared to the items discussed earlier in this document. Notwithstanding these other items of differences not discussed, there are additional matters which should be discussed.

a. Rate design.

As discussed on pages 44 through 49 of CA-T-1, additional analysis of the appropriate rate design is necessary, but it does not appear reasonable to conduct that analysis in the instant rate proceeding. Given the recent changes in the service territory and continued results of the current economic conditions in Hawaii and on Molokai, conducting any such analysis would have extremely limited value as those conditions will (hopefully) change and any such analysis at this time would likely yield skewed results. It would be more productive to reserve any such analysis as a future requirement, especially after WOMI is able to produce more reliable evidence regarding its expenses and plant investments. For this reason, the Consumer Advocate agrees that an "across-the-board" increase of the results of the Commission's decision in its final decision and order as well as any interim decision and order would be appropriate.

b. Strongly recommend avoiding the need for a refund.

The Consumer Advocate contends that its recommended revenue requirement is reasonable. However, as acknowledged in direct testimony, it may be possible that WOMI will be able to provide additional information that might support changing some of the Consumer Advocate's estimates. However, as that information has not yet been submitted, the Consumer Advocate would like to emphasize that if WOMI's rebuttal

position is adopted as the appropriate level of revenue requirements for probable entitlement and the Commission later decides that WOMI has not adequately supported its revised request, a refund to customers of the difference between the interim and final rates would be required. As recommended by the Consumer Advocate, there should be no rate of return even though WOMI continues to assert that some level of return, two percent, is appropriate.⁷ If a refund is necessary, the appropriate interest will also need to be calculated and WOMI will need to develop a refund plan for Commission approval.

The Consumer Advocate contends that it is more appropriate, especially in these current economic conditions, that the Commission adopts the lowest possible revenue requirement estimate in order to avoid: 1) unnecessarily taking money out of the utility customers' pockets even if it will be returned in the future in the event of a refund; and 2) the regulatory work that would be required to develop and calculate a refund plan.

IV. RECOMMENDATION.

In conclusion, WOMI is probably entitled to a rate increase of 320.7% (i.e., $(\$454,629 - \$108,057) \div \$108,057$). The calculation of this amount is illustrated on Attachment 1 to this statement of probable entitlement and greater details on the basis for each revenue requirement element and the calculations can be found in CA-T-1 and the supporting exhibits. The Consumer Advocate acknowledges that this amount is significant, but due to the fact that WOMI has not sought a rate increase

⁷ WOMI-RT-100, pages 24 – 26.

since its CPCN in 1993, the likelihood of a large increase was high. It might be possible with the results of further analysis, including management audits that examine the appropriateness of allocations and the productivity/efficiency of the utility operations might yield a lower cost of service. Based on the information available at this time, however, the increase over the rates authorized in Decision and Order No. 12125 should approximate the estimate set forth in Attachment 1. For the reasons discussed in the Consumer Advocate's Direct Testimony, the entire increase should be applied on an across-the-board basis.

DATED: Honolulu, Hawaii, March 16, 2010.

Respectfully submitted,

By 
DEAN NISHINA
Executive Director

DIVISION OF CONSUMER ADVOCACY

Waiola O Molokai
Revenue Requirements & Rate of Return Summary
Test Year Ending June 30, 2010

Line #		Present Rates	Additional Amount	Proposed Rates at 0.00%
1	Monthly Customer Charge	\$31,125	\$99,624	\$130,749
2	Water Usage Charges	75,832	246,948	322,780
3	Other	0		0
4	Connection Fees	0		0
5	Late Fees	1,100		1,100
6				
7	Total Operating Revenues	108,057	346,572	454,629
8	Labor, PR Taxes & Employee Benefits	101,242		101,242
9	Fuel & Power	7,391		7,391
10	Cost of Sales	95,680		95,680
11	Treatment Charges & Chemicals	0		0
12	Materials & Supplies	13,581		13,581
13				
14	Affiliated Charges	9,660		9,660
15	Professional & Outside Services	3,156		3,156
16	Repairs & Maintenance ("R & M")	10,519		10,519
17	Rents	0		0
18	Insurance	16,000		16,000
19	Regulatory Expense	55,000		55,000
20	General & Administrative	5,885		5,885
21				
22				
23	Total O&M Expenses	318,113	0	318,113
24	Taxes, Other Than Income	6,899	22,129	29,028
25	Depreciation	107,490		107,490
26				
27	Income Taxes	0	0	0
28	Diff due to changing factors			0
29	Total Operating Expenses	432,503	22,129	454,631
30	Operating Income	(\$324,446)	\$324,443	(\$2)
31	Average Rate Base	\$1,249,647		\$1,249,647
32	Return on Rate Base	-25.96%		0.00%
33	Target ROR	0.00%		
34	Increase in ROR	-25.96%		
35	Increase in NOI	324,446		
36	GRCF	1.06820		
37	Increase in Revenues	\$346,573	\$1	
38	Percent Increase in Revenue		320.73%	

Waiola O Molokai
Income Tax Expense
Test Year Ending June 30, 2010

Line #	Description	[1] Tax Rates	Taxable Amounts			[5] Present Rates	Income Taxes		[8] Difference in Income Tax Calculations [4] + [5] - [6]
			[2] Present Rates	[3] Revenue Increase	[4] Proposed Rates		[6] Revenue Increase	[7] Proposed Rates	
1	Total Revenues					108,057	346,572	454,629	
2	Total Operations & Maintenance Expenses					318,113	0	318,113	
3	Depreciation					107,490	0	107,490	
4	0					0	0	0	
5	Taxes Other than Income Taxes					6,899	22,129	29,028	
6	Total Operating Expenses					432,503	22,129	454,631	
7	Operating Income before Income Taxes					(324,446)	324,443	(2)	
8	Interest Expenses					0	0	0	
9	State taxable income					(324,446)	324,443	(2)	
	Less:								
	<u>State Income Tax</u>								
10	less than \$25K	4.4%	(25,000)	25,000	25,000	0	1,100	0	
11	Over \$25K, but less than \$100K	5.4%	(75,000)	75,000	(25,002)	0	4,050		
12	Over \$100K	6.4%	(224,446)	224,443		0	14,364	0	
13	State Income Taxes					0	19,514	0	19,514
14	Federal taxable income					(324,446)	304,929	(2)	
	<u>Federal Income tax</u>								
15	less than \$50K	15.0%	(50,000)	50,000	(2)	0	7,500	0	
16	Over \$50K, but less than \$75K	25.0%	(25,000)	25,000		0	6,250	0	
17	Over \$75K, but less than \$100K	34.0%	(25,000)	25,000		0	8,500	0	
18	Over \$100K, but less than \$335K	39.0%	(224,446)	235,000		0	91,650	0	
19	Over \$335K	34.0%		(30,071)			(10,224)		
20	Federal Income Taxes					0	103,676	0	103,676
21	Total Federal and State income taxes					\$0	\$123,190	\$0	\$123,190
22	<u>Effective Tax Rate</u>					0.0000%	37.9697%	0.0000%	
23	State					0.000%	6.015%	0.0000%	
24	Federal					0.000%	31.955%	0.0000%	

Waiola O Molokai
Taxes Other Than Income Taxes
Test Year Ending June 30, 2010

Line #	Description	[1] Revenues at Present Rates	[2] Revenues at Proposed Rates	[3] Tax Rates	[4] Taxes at Present Rates	[5] Taxes at Proposed Rates
<u>Revenue Taxes</u>						
1	Public Company Service Tax (Pursuant to HRS § 239)	\$108,057	\$454,629	5.885%	\$6,359	\$26,755
2	Public Utility Fee (Pursuant to HRS § 269-30)	108,057	454,629	0.500%	540	2,273
3	Franchise Tax (applicable to electric companies only) (Pursuant to HRS § 240)			2.500%		
4	Total Revenue Taxes				<u>6,899</u>	<u>29,028</u>
<u>Other Taxes</u>						
5	Name					0
6	Total Other Taxes				<u>0</u>	<u>0</u>
7	Total Taxes Other Than Income Taxes				<u>\$6,899</u>	<u>\$29,028</u>

Waiola O Molokai
Average Rate Base
Test Year Ending June 30, 2010

Line #	Description	[1]	[2]	[3]
		At June.30, 2009	At June. 30, 2010	Average
	<u>Plant In Service</u>	\$3,333,813	\$3,333,813	\$3,333,813
1	Accumulated Depreciation Reserve	2,001,308	2,108,798	2,055,052
2	Net Plant-in-Service	1,332,506	1,225,016	1,278,761
	<u>Deduct:</u>			
3	Net Contributions in Aid of Construction	0	0	0
4	Customer Advances	0	0	0
5	Customer Deposits	(43,710)	(43,710)	(43,710)
6	Accumulated Deferred Taxes: Federal	7,932	(984)	3,474
7	Accumulated Deferred Taxes: State	0	0	0
8	Unamortized Hawaii General Excise Tax Credit	(18,651)	(12,121)	(15,385)
9	subtotal	(54,429)	(56,815)	(55,621)
	<u>Add:</u>			
10	Working Capital	26,509	26,509	26,509
11	Retirements	0	0	0
12	subtotal	26,509	26,509	26,509
13	Total at End of Year	\$1,304,585	\$1,194,709	
14	Average Rate Base For Test Year			\$1,249,647

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S STATEMENT OF PROBABLE ENTITLEMENT** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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1 copy
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Counsel for County of Maui

DATED: Honolulu, Hawaii, March 16, 2010.


